

Franchising

A legal guide to
investing in a franchise



It is vital to get reliable information before entering into a franchise agreement.

What is it like to work in the system?

What must you invest?

What are your legal rights and obligations?

The Queensland Law Society recommends you get advice from your solicitor and your financial adviser before you commit yourself.

Franchising is one of the most significant growth areas in Australian small business and therefore of great importance to our economy.

Franchising offers the special benefit of providing a ready-made market through its high-profile image and trademark awareness, without the high risk of establishing a totally new business.

Initial things to consider

You must understand the relationship between the franchisor (the owner of the franchise system) and the franchisee. It is a unique type of business relationship that is ongoing and depends on trust and confidence between the parties.

Operating a franchise is not the same as operating an independent business. You need to follow the system and to be able to conform. If you do not fully understand franchising there are courses available through the Franchise Council of Australia or through the Queensland Department of State Development.

Make sure you do not go into business under capitalised. If you need to borrow, ask yourself if you're prepared to put your assets at risk.

Research

Just because there is an established franchise system does not mean the area you are considering has a demand for those goods and services. Going into a franchise means setting up a business, and as with any other business, there needs to be the demand for the goods and services for the business to succeed.

You should investigate whether the product or service is in demand in the franchised area.

If there is direct competition in the area it may not be an issue if the product or service you intend to offer is superior and highly sought after.

Is there any litigation?

You should determine whether or not any actual or threatened litigation exists. Threatened litigation could turn into legal proceedings.

Litigation can be very time consuming in any franchise system and the franchisor must be able to handle the litigation as well as look after the system.

Remember, litigation can arise because a franchisor is simply enforcing their rights to either defend or prosecute any action. On the other hand, if a franchisor cannot justify the litigation to your satisfaction, you should be concerned about that litigation.

Does the franchisor run any other businesses?

A number of franchise systems are involved in what is called parallel franchising. That means they have different franchise systems running at the same time. If this is the case, then you should check the other business does not have an adverse effect on the proposed franchise.

Is there a franchise expansion plan?

Most franchise systems have a franchise expansion plan. You should ensure the expansion plan will not have an effect on any existing franchised business. Enquiries also should be made to see whether expansion in the past has affected any businesses that existed at that time.

Are projected earnings provided by the franchisor?

A franchisor can tell you to do your own business plan and does not have to make any comment about whether they think it will succeed.

An experienced franchisor will often give a range of figures including the highest and the lowest earning franchises.

You should take the figures to your financial adviser and accountant and make sure they have sufficient information to be able to determine whether the franchise business is a viable proposition. Enquiries should be made to determine where the franchisor obtained the information and whether it is a true reflection of franchisees' actual earnings at that time.

Terms and conditions of the franchise documents

Under the Franchising Code of Conduct, the franchisor must give you a disclosure document and a copy of the Code at least 14 days before the agreement is signed. You are required to advise the franchisor in writing that you have:

- read and understood the Code and the disclosure document
- received independent legal and financial advice or have chosen not to do so.

Because of the amount of information in the disclosure document, your accountant will be in a position to advise whether the fees payable under the franchise agreement are excessive and whether or not they can be satisfied from the gross turnover of the business.

Your accountant will also give advice on the right structure you should use – this might be a company, a sole trader or a partnership.

Your solicitor will be able to give advice concerning your legal rights and obligations under the franchise agreement and whether or not the franchise agreement complies with the Franchising Code of Conduct.

Cooling off

Once a franchise agreement has been signed, you have a 7-day cooling-off period. If you do change your mind, then the franchisor is required to refund all money paid under the franchise agreement less a reasonable amount for costs and expenses as set out in the Code.



Mandatory terms

A number of terms in a franchise agreement are mandatory under the Code. These include:

- the franchisee must not be required to sign a general release
- the franchisor cannot prohibit franchisees from meeting together for a lawful purpose
- there are particular clauses regarding any marketing fund and the auditing of the marketing fund and providing of accounts
- the franchisor must consider a request for consent to assignment/sale of the franchise within a certain time and can only refuse consent under certain circumstances
- the franchisor must give notice requiring breaches to be remedied and give the franchisee the opportunity to remedy the breaches before the franchisor can terminate. The franchisor can terminate the agreement without notice in some circumstances, including:
 - you do not hold a licence required to run the business
 - you become bankrupt
 - you operate the business in a way that endangers public health or safety
 - you abandon the business.

The franchisor will give a copy of the Code to prospective franchisees with the disclosure document so the franchisee can see the terms and conditions that need to be included in the franchise agreement.

Operating procedures

Franchise fees will be payable up-front in most cases but paying the franchise fee and having the best intention to succeed does not guarantee success in franchising.

Some issues you may need to address are:

- is the franchise subject to limited territory
- is there a limit on the type of goods or services sold
- what is the source of supplies
- are there royalties payable or other regular payments
- what is the position with refunds; premises design and cost
- is personal involvement in the franchise business required
- are trading hours set
- does the franchisor have an operations manual
- are formal training programs offered
- what assistance is given by the franchisor
- who are the franchisor's competitors
- are there any performance obligations
- do you have the franchisor's latest accounts
- what does the lease say

Answering these questions should give you sufficient information to develop a business plan – an essential step before entering into any franchise agreement.



Intellectual property

Intellectual property is property such as patents, trade marks, designs, copyright, trade secrets, confidential information, know-how, practices and procedures.

In any franchise, part of the property that is being sold and/or purchased is intellectual property. It is often the intellectual property that gives the franchise its significant reputation and goodwill that is reflected in the purchase price for the franchise.

It is therefore important for you to ensure that ownership of the intellectual property which forms part of the franchise is secure, and is in a form capable of being sold or licensed to a franchisee. You should identify what is being sold as part of the franchise and ensure it is capable of being sold or licensed to you.

Under the Franchising Code of Conduct, full details of the franchised intellectual property must be disclosed in the disclosure document. As well, the franchise agreement should reflect these details and grant the rights that you need to conduct the franchise.

Independent searches should be conducted to check the status of the intellectual property and the correctness of the information contained in the disclosure document and franchise agreement.

Details regarding web sites, domain names and ownership and use of these marketing tools will also need to be addressed.

These aspects of the franchise are as important as the goods and services which are being sold as part of the franchise business, especially if it is intended to conduct an e-franchise business.

Fees and payments

Starting up a business costs money, whether you are buying a franchise or operating independently. It is vital that you know at the outset what money must be spend on setting up the franchise, and what ongoing payments must be made.

Start-up costs

Before the business starts operating you will face a range of expenses, including:

- fitting out the premises, or mobile unit
- acquiring equipment fixtures fittings and tools
- opening stock/inventory
- paying fees to your professional advisors
- insuring – including workers compensation, public risk, motor vehicle and so on.

You must allow for working capital to pay your business expenses until you can pay them out of income.

Importantly, you must make sure that all payments, costs and expenses are covered in your initial budget. The franchisor's disclosure document will detail some of the typical expenses involved. Experienced franchisors should know what needs to be done and what it should cost. Many can negotiate reduced rates on some items because of the buying power of the group.

Even so, you should check and verify all the set-up costs yourself and not rely solely on the information provided by the franchisor. In particular, check the cost quoted by contractors who are recommended or associated with the franchisor.

Initial fee

The initial fee is essentially a payment for the right to join the franchise network and to use the franchisor's system and name.

The amount of the initial fee will differ from one franchise system to another. It ranges from a few thousand dollars to over one hundred thousand dollars. It is important to compare the fee amongst other franchise systems in the same industry, so that you get a good idea as to what is reasonable. When doing this comparison, examine carefully what is included in the initial fee and what is supplied at an additional cost. Sometimes the lowest fee may not be the best value because of the high add-on cost to be paid.

Enquiries should be made to determine whether the initial fee includes the cost of training. Sometimes this is charged as an additional fee. Look carefully at where the training is to be conducted and how long it runs. It is likely you will have to pay for travelling and accommodation expenses for yourself and for staff who need to attend training.

Ongoing payments

Most franchise agreements provide for an ongoing payment to be made to the franchisor. This payment may be required weekly, fortnightly or monthly. It is important to determine how much these payments will be and when they must be made.

Ongoing payments are usually classed as royalty fees or service fees. They are paid so that you may have the right to continue to use the franchisor's trademark and branding, but they also constitute a fee for services that the franchisor is to provide for you. If it is intended to be payment for ongoing service, check that the fee fairly equates to the level of service that is being provided, and that the franchise agreement specifically requires the franchisor to provide this service to you.

Ongoing payments are usually based on either a percentage of turnover or as a flat fee, or sometimes a combination of both. You should ensure that you understand how the fees are to be calculated and what they will be.

You may also be required to pay money into a group advertising fund. Under the franchise agreement, you may be required to spend a minimum amount on advertising your own business, in addition to any amount that you have paid to the advertising fund.

Other fees

It is important that you read the disclosure document and franchise agreement carefully so you are aware of other fees and charges that may be payable. For example, you will usually be required to pay the franchisor's legal fees for the preparation of the franchise agreement. If the business operates from premises which are leased by the franchisor and subleased or licensed to you, then you must also pay the stamp duty on that sublease or licence agreement. You may also be required to pay the head lessor's legal fees in consenting to the grant of the lease or sublicense to you. You could also be responsible for paying all of the fees, charges and payments under the head lease as well as under the sublease or licence.

If you breach the agreement you will be required to pay the franchisor's legal fees. If the franchisor audits your financial records (as is usually required under the franchise agreement) and finds a discrepancy in the figures, you may also be required to pay the cost of that audit.

If the franchisor revises or updates the corporate image of the franchise, you may be required to pay the cost of new signage and stationery.

Dispute resolution

The Franchising Code of Conduct includes specific requirements for the resolution of disputes between a franchisor and franchisee. These requirements are contained in Part 4 of the Code, and principally involve the use of mediation as the method of dispute resolution where the parties cannot reach an agreement.

Every franchise agreement entered into after 1 October 1998 must contain a complaint-handling procedure that complies with the Code. The procedure involves the complainant (which may be the franchisor or the franchisee) giving written notice to the respondent, setting out the nature of the dispute and the action that the complainant believes will resolve the dispute.

No particular form is required, although it is important the notice clearly sets out the nature of the complaint so that the respondent knows what they have to address, and how the complainant would like to resolve the matter.

After the complainant has given notice, the parties must attempt to resolve the dispute between themselves. There is no time limit for the attempted resolution as such, but if there is no agreement within a three week period, either party may refer the matter to mediation.



Mediation

Mediation is a procedure where an independent person is appointed to facilitate a meeting between the parties to discuss and resolve the dispute. Mediators do not have the authority to pass judgement or to make any binding decisions. The mediator controls the mediation process, in circumstances such as the parties not agreeing the time or place for mediation, but otherwise the mediator cannot force the parties to reach any, or any particular, result.

Mediation is intended to be a low-cost alternative to issuing proceedings through court. It is generally accepted as being a valuable method of obtaining a quick, fair and open discussion of the issues in dispute.

A failure to attend, or a failure to participate fairly in the mediation, may allow the other party to raise that conduct in any court proceedings. Generally, the discussions in a mediation cannot be used in court. This is to allow a full and frank exchange of ideas and possible solutions without fear of admitting liability or wrongdoing.

If the parties cannot resolve a dispute between themselves and if they cannot agree about who the mediator is to be, they can refer the appointment to the Office of the Mediation Adviser (the OMA). The OMA maintains a panel of experienced mediators for each State and on the request of either party, will refer the dispute to a mediator.

The costs of the mediation are paid equally by each party, unless otherwise agreed. Each party is responsible for their own costs of attending the mediation.

If a party wants legal representation at the mediation, this is usually discussed with the mediator and the other party beforehand. The whole purpose of mediation is to move away from the technical issues of who is right or wrong, and focus more on the practical ways that the dispute can be resolved to the benefit of both parties.

Mediation does not prevent a party from commencing proceedings in a court. However, mediation can often be a valuable part of the court process, if only in limiting the issues in dispute, which saves time and expense.

Conclusion

You should never buy a franchise without considering all the information available. The Franchising Code of Conduct now requires that you be given an opportunity to obtain professional advice, including legal, financial and accounting advice, before investing in a franchise. The Queensland Law Society recommends you take that opportunity to get independent advice about the system you propose to invest in, and your rights and obligations.



Further information can be obtained from –

Franchise Council of Australia

GPO Box 1498N
Melbourne VIC 3001

Telephone 1300 669 030
Facsimile 03 9822 7752

www.franchise.org.au

Queensland Department of State Development

PO Box 168
Albert Street Brisbane Qld 4002

Telephone 13 26 50

www.sd.qld.gov.au

Australian Competition and Consumer Commission

PO Box 10048
Adelaide Street Post Office
Brisbane Qld 4002

Telephone 07 3835 4666
Facsimile 07 3832 0372

www.accc.gov.au

A copy of the Franchising Code of Conduct can be obtained from either of these websites.

Need a solicitor?

If you do not have a solicitor, contact the Queensland Law Society's Referral Service on 07 3842 5842.

The information in this brochure is merely a guide and is not meant to be a detailed explanation of the law. The Queensland Law Society recommends you see your solicitor for personalised legal advice.



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